

**806 KAR 7:090. Custodial accounts for investment securities of insurance companies.**

RELATES TO: KRS 304.7-360

STATUTORY AUTHORITY: KRS 304.2-110, 304.7-360

NECESSITY, FUNCTION, AND CONFORMITY: KRS 304.2-110 authorizes the Commissioner of Insurance to promulgate administrative regulations necessary for or as an aid to the effectuation of any provision of the Kentucky Insurance Code as defined in KRS 304.1-010. KRS 304.7-360 requires the Commissioner of Insurance to promulgate administrative regulations governing the deposit by insurers of securities with clearing corporations, the Federal Reserve book-entry system, and with custodian banks. This administrative regulation establishes provisions to be included in an agreement for the custody of an insurance company's securities with a custodian bank and qualifications for a custodian bank.

**Section 1. Definitions.**

- (1) "Certificated security" is defined by KRS 304.7-360(1)(g).
- (2) "Clearing corporation" is defined by KRS 304.7-360(1)(a).
- (3) "Commissioner" is defined by KRS 304.1-050(1).
- (4) "Custodian bank" is defined by KRS 304.7-360(1)(b).
- (5) "Custodied securities" means securities held by the custodian bank, its nominee, a clearing corporation, the Federal Reserve book-entry system, or in any combination of these entities.
- (6) "Direct participant" is defined by KRS 304.7-360(1)(c).
- (7) "Federal reserve book-entry system" is defined by KRS 304.7-360(1)(d).
- (8) "Member bank" is defined by KRS 304.7-360(1)(e).
- (9) "Security" is defined by KRS 304.7-360(1)(f).
- (10) "Uncertificated security" is defined by KRS 304.7-360(1)(h).

**Section 2. Standards for Custodial Agreements.** Pursuant to KRS 304.7-360, an insurance company may provide by agreement for the custody of its securities with a custodian bank meeting the qualifications set forth in Section 3 of this administrative regulation which securities may be held by the custodian bank, its nominee, in a clearing corporation, or in the Federal Reserve book-entry system. Any agreement shall contain provisions to comply with the following standards:

- (1) The agreement shall be in writing and shall be authorized by a resolution of the Board of Directors or an authorized committee of the insurance company.
- (2) Certificated securities held by the custodian bank may be held separate from the securities of the custodian bank and of all its other customers or in a fungible bulk of securities as part of a Filing of Securities by Issue (FOSBI) arrangement.
- (3) Securities held in a fungible bulk by the custodian bank and securities in a clearing corporation or the Federal Reserve book-entry system shall be separately identified on the custodian bank's official records as being owned by the insurance company. The records shall identify which custodied securities are held by the custodian bank or by its nominee and which securities are in a clearing corporation or the Federal Reserve book-entry system. If the securities are in a clearing corporation or the Federal Reserve book-entry system, the records shall also identify where the securities are and, if in a clearing corporation, the name of the clearing corporation or, if held in nominee name, the name of the nominee.
- (4) All custodied securities that are registered shall be registered in the name of:
  - (a) The insurance company;

- (b) A nominee of the insurance company;
  - (c) The custodian bank or its nominee; or
  - (d) If in a clearing corporation, the clearing corporation or its nominee.
- (5) Custodied securities shall be held subject to the instructions of the insurance company and shall be withdrawable upon the demand of the insurance company.
- (6) The custodian bank shall arrange for execution of transactions in custodied securities in accordance with the insurance company's instructions and shall not exercise discretionary authority to effect transactions in custodied securities except in such limited or special circumstances as the insurance company may authorize.
- (7) The custodian bank shall be required to send or cause to be sent to the insurance company a confirmation of all transfers of custodied securities to or from the account of the insurance company. In addition, the custodian bank shall be required to furnish the insurance company with reports of holdings of custodied securities at such times and containing such information as may be reasonably requested by the insurance company, but not less frequently than monthly.
- (8) During the course of the custodian bank's regular business hours, any officer or employee of the insurance company, any independent accountant selected by the insurance company, or any representative of the commissioner shall be entitled to examine, on the premises of the custodian bank, the custodian bank's records relating to custodied securities and the custodied securities, but only upon furnishing the custodian bank with written instructions to that effect from an appropriate officer of the insurance company or the commissioner.
- (9) The custodian bank and its nominee shall be required to send to the insurance company:
- (a) All reports which they receive from a clearing corporation or the Federal Reserve book-entry system on their respective systems of internal accounting control; and
  - (b) Reports prepared by outside auditors with respect to the respective systems of internal accounting control of the custodian bank and its nominee pertaining to custodial record keeping as the insurance company may reasonably request from time to time.
- (10) The custodian bank shall maintain records sufficient to determine and verify information relating to custodied securities that may be reported in the insurance company's annual statement and supporting schedules as filed with various regulatory authorities and in connection with any audit of the financial statements of the insurance company.
- (11) The custodian bank shall provide upon request an affidavit with respect to custodied securities on the form, Custodian Affidavit or in a substantially similar format.
- (12) The custodian bank shall be obligated to indemnify the insurance company for any loss of custodied securities, except that the custodian bank shall not be obligated to the extent that the loss was caused by other than the negligence or dishonesty of the custodian bank.
- (13) If there is a loss of custodied securities for which the custodian bank shall be obligated to indemnify the insurance company as provided in subsection (12) of this section, the custodian bank shall promptly replace the securities or the value of the securities and the value of any loss of rights or privileges resulting from the loss of securities.
- (14) The agreement may provide that the custodian bank will not be liable for any failure to take any action required to be taken under the agreement if the taking of such action is prevented or delayed by war, whether declared or not and including existing war, revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosion, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause beyond its reasonable control.
- (15) If entry in a clearing corporation or in the Federal Reserve book-entry system is gained through a direct participant or a member bank, there shall be an agreement between the cus-

todian and the direct participant or member bank under which the direct participant or member bank shall be subject to the same liability for loss of custodied securities as the custodian bank. However, if the direct participant or member bank shall be subject to regulation under the laws of a jurisdiction which is different from the jurisdiction the laws of which regulate the custodian bank, the commissioner may accept a standard of liability applicable to the direct participant or member bank which is different from the standard of liability applicable to the custodian bank.

(16) The agreement shall be terminable by the insurance company on not more than thirty (30) days' notice.

Section 3. Qualifications of Custodian Banks. Any custodian bank selected by an insurance company to act as custodian under an agreement authorized by KRS 304.7-360 shall possess the following qualifications:

(1) Its custodial functions for the insurance company shall be carried out under its trust department;

(2) It shall be audited annually by independent public accountants whose audit report, together with the related financial statements, and whose report on internal controls are made available to the insurance company and the commissioner;

(3) It shall be organized under the laws recognizing that the custodied securities are special deposits rather than general deposits, remain the specific property of the insurance company, and shall not be subject to any creditor relationship of the custodian bank.

(4) It shall maintain blanket bond coverage relating to its custodial functions with limits equal to or exceeding those suggested by the American Bankers Association.

(5) Its capital and surplus funds shall equal or exceed \$25,000,000; and

(6) It shall have demonstrated sufficient experience in handling custodial accounts.

Section 4. Incorporation by Reference. (1) "Custodian Affidavit", (6/2020), is incorporated by reference.

(2) This material may be inspected, copied, or obtained, subject to applicable copyright law, at the Kentucky Department of Insurance, 500 Mero Street, Frankfort, Kentucky 40601, Monday through Friday, 8 a.m. to 4:30 p.m. (9 Ky.R. 89; 375; eff. 10-6-1982; TAm eff. 8-9-2007; Crt eff. 2-26-2020; 47 Ky.R. 405, 971; eff. 2-2-2021.)